



A REPORT
TO THE
MONTANA
LEGISLATURE

PERFORMANCE AUDIT

Coordination of Liquor Licensing Compliance Programs

*Department of Revenue
Department of Justice*

JUNE 2017

LEGISLATIVE AUDIT
DIVISION

16P-02

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PERFORMANCE AUDITS

Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Members of the performance audit staff hold degrees in disciplines appropriate to the audit process.

Performance audits are conducted at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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June 2017

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of the Coordination of Liquor Licensing Compliance Programs, managed by the Liquor Control Division of the Department of Revenue and the Gambling Control Division of the Department of Justice.

This report provides the legislature information about application for and renewal of various types of alcohol licenses, as well as compliance with existing laws and rules. This report includes recommendations for improving compliance efforts and coordination within and between the agencies. Written responses from the Department of Revenue and the Department of Justice are included at the end of the report.

We wish to express our appreciation to personnel at the Department of Revenue and the Department of Justice for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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ELECTED, APPOINTED, AND ADMINISTRATIVE OFFICIALS

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MONTANA LEGISLATIVE AUDIT DIVISION

Performance Audit Coordination of Liquor Licensing Compliance Programs Department of Revenue Department of Justice

JUNE 2017

16P-02

REPORT SUMMARY

The Montana Department of Revenue and Department of Justice share responsibility for licensing and regulation of the state's many classes of alcohol licenses. The agencies work closely to ensure the licensing process is as smooth as possible for applicants. However, the agencies could take steps to improve licensee compliance with state laws and rules, in the areas of on-site inspections of licensed premises; communication with local law enforcement agencies; and ensuring certain categories of licensed businesses are operated in accordance with law.

Context

Montana is one of 17 states that operates under a "control" model of alcoholic beverage regulation, a system that has been in place since shortly after the end of Prohibition. Control states attempt to promote moderation of consumption through strict control of the manufacture, distribution, and retail sale of alcoholic beverages. The Montana Department of Revenue and Department of Justice share oversight of the licensing and compliance processes for alcoholic beverage sales. Agreements between the agencies delegate tasks and responsibilities in the areas of license application review and approval; receipt and action on complaints about licensees; compliance with existing laws and rules; and review and approval of license renewals.

Our review looked at the timelines and processes for review of initial license applications and license renewals. We also reviewed complaints received by both agencies, as well as a log of violations cited by the Department of Revenue. We interviewed holders of several types of licenses and other interested parties. We examined processes for on-site compliance visits to licensed businesses

and other compliance work done by the Department of Revenue. We interviewed officials at each agency regarding several aspects of the licensing and compliance work done by the state as well as by local law enforcement agencies.

Results

Our audit found that initial alcohol license applications are generally processed and approved or denied within the time frame specified by law. However, we found no formally required mechanism for the reporting of violations between local law enforcement agencies and the Department of Revenue, leading to the possibility that alcohol citations may be unreported to the state. We found that the Department of Revenue can improve its compliance work in the area of confirming information asserted by licensees on their annual renewal forms. And we determined that on-site compliance efforts can be improved by the Department of Justice with the addition of alcohol-related items to a checklist used by inspectors in the field.

(continued on back)

Recommendation Concurrence	
Concur	4
Partially Concur	0
Do Not Concur	0
Source: Agency audit response included in final report.	

For a complete copy of the report (16P-02) or for further information, contact the
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Chapter I – Introduction and Background

Introduction

Shortly after the end of Prohibition in the 1930s, Montana sought to control the distribution and consumption of alcoholic beverages. Montana is one of 17 states that operates under a “control” model of alcoholic beverage regulation. Control states attempt to promote moderation of consumption through strict control of the manufacture, distribution, and retail sale of alcoholic beverages. The intent of this state control is to reduce alcohol consumption and attendant health issues, as well as accidents involving alcohol.

In Montana, the Department of Revenue’s (DOR) Liquor Control Division (Liquor Control) controls wholesale distribution of liquor—virtually every bottle of liquor sold in Montana passes through the agency’s distribution warehouse in Helena. Across Montana, 96 retail liquor stores operate through a franchise agreement with the state that must be reviewed and renewed every 10 years. The state also controls the on-premises consumption of alcoholic beverages (bars, restaurants, etc.), through a quota system that limits the number of businesses that may sell alcoholic beverages in an area based upon population.

More than 7,000 alcohol licenses of various types must be processed or renewed annually, including those for the retail sale of distilled spirits, beer or wine, vendor permits, winery registrations, distributors, breweries, specialty beer and wine permits, and airport and golf course licenses. These licenses are renewed by Liquor Control, working in conjunction with the Gambling Control Division (Gambling Control) of the Department of Justice (DOJ). Due to ongoing legislative interest in liquor licensing issues, the Legislative Audit Committee prioritized a performance audit of the liquor licensing process.

Audit Scope and Objectives

Through our assessment work, we identified areas of potential risk in the license application and oversight processes. We also identified risk in the conduct of complaint investigations, compliance checks, and other areas of licensing application and renewal processes and general licensee oversight. This chapter discusses the scope of our work, provides background information on liquor licensing in the state, and outlines the areas where we conducted audit work.

The development of the scope of the audit focused on several of the identified risk areas. In the area of license application, we focused on the process followed by applicants as

well as communication with both DOR and DOJ, as each agency has multiple roles in processing and approving new license applications. We reviewed standards that ensure licenses are issued in accordance with statute and administrative rules.

The scope of the audit also included license renewals, which are submitted and processed annually for holders of all types of alcohol licenses. The renewal process is much shorter than the initial application process but still presented areas of risk to DOR. We also conducted compliance work in the field and reviewed work done by both state agencies as well as by local law enforcement agencies.

This audit was not an assessment of the state's overall regulatory approach to liquor licensing, and does not attempt to address questions about licensing laws generally and any effects the state's regulatory climate has on competition, restraint of trade, temperance, and related issues.

The time frame for all records and document reviews was calendar year 2015, which was the most recent year for which complete data was available at the time most field work was completed. Site visits were conducted primarily in 2016. Interviews and file reviews were completed in 2016. Our review focused primarily, but not exclusively, on on-premises consumption licenses, including all-beverage, beer, beer and wine, and restaurant beer and wine licenses. We also interviewed licensees with several brewing operations and taprooms.

Because the agencies work in parallel on license applications, audit work also focused on coordination between the agencies as they completed license applications, renewals, and licensee compliance. Our work focused on how each agency complies with respective liquor licensing laws, a memorandum of understanding between the two agencies, and a joint procedures manual that outlines licensing responsibilities for each agency.

In developing our audit plan we pursued answers to the questions presented in the following audit objectives:

1. Is the process for reviewing and approving initial license applications consistent and is it being done within the time frame specified in state law?
2. Are standards and processes consistent and reliable for accepting and addressing complaints leveled against alcohol beverage licensees?
3. Are DOJ Gambling Control and DOR Liquor Control conducting compliance reviews and audits of licensees that address compliance with state law and administrative rules for the particular type of license held?

Audit Methodologies

To address our three audit objectives, we conducted the following methodologies:

- ♦ Reviewed Montana Code Annotated and Administrative Rules of Montana that govern activities related to the audit objectives.
- ♦ Obtained and reviewed available goals and objectives, policies and procedures, and management controls, for both agencies that oversee the licensing and compliance processes.
- ♦ Reviewed a random sample of 78 initial license applications in the data processing system used by the departments to track and process applications (20 percent of the total) for calendar year 2015, inspecting for timeliness, completeness, and verification of compliance work.
- ♦ Conducted interviews with agency staff, licensees and applicants, and stakeholder associations.
- ♦ Surveyed licensees to learn their views on the licensing process and timeline and other topics related to their interactions with Liquor Control and Gambling Control.
- ♦ Identified a sample of existing licensees and applicants to visit and conduct observations and interviews.
- ♦ Observed a liquor license drawing held by Liquor Control to verify the drawing was held in a fair and objective manner.
- ♦ Reviewed GenTax licensee records and population-based quota standards to determine whether the number of licenses in a jurisdiction exceeds the number permitted by law.
- ♦ Reviewed the licensing documentation at Liquor Control and Gambling Control to determine how licensee compliance with all license requirements is fulfilled, including that related to management and ownership structure, alcohol-related violations or citations, worker training, and for certain licensees, required food sales.
- ♦ Reviewed complaints filed with both Liquor Control and Gambling Control for 2015, as well as a log of all actions taken against licensees by Liquor Control as a result of violations or citations.

Program Background and Agency Organization

Liquor licensing in Montana is conducted and overseen jointly by the Department of Revenue Liquor Control Division and the Department of Justice Gambling Control Division. A 38-page Joint Procedures document between the two divisions outlines the responsibilities of each in the licensing process, and Montana Code and Administrative Rules also address the responsibilities of each division in the licensing, renewal, and compliance arenas.

Gambling Control was created as a law enforcement agency in 1989 when the state moved to regulate all forms of gambling, taking that authority away from local governments. In 1993 all liquor law enforcement investigation authority was statutorily transferred from DOR to DOJ. Gambling Control currently has 18 investigators who conduct all of the background investigations of liquor license applicants as well as conducting complaint investigations against active licensees. Investigators work in field offices around the state and conduct background checks of license applicants (alcohol as well as gambling), and conduct unannounced field visits to licensees to ensure compliance with laws and rules. The division also has four auditors who conduct the financial review of all liquor license applications.

The Department of Revenue's Liquor Control Division is split into two bureaus, Licensing and Distribution. The Licensing Bureau, which was the focus of the majority of audit work at this agency, reviews license applications to ensure they meet statutory requirements relative to ownership, payment of taxes and fees, business operation, and other requirements, as well as confirming there is an available license within population quota guidelines. Liquor Control is also charged with processing renewals of all alcohol licenses, and communicates with both Gambling Control and with local law enforcement agencies across the state on matters of compliance and violations/citations.

Report Contents

The remainder of this report details our analysis of the objectives and contains four recommendations. It is organized in two additional chapters:

- ♦ Chapter II: Additional background into the quota and licensing system, including how quotas are established; floating licenses; and the lottery system for distributing new licenses.
- ♦ Chapter III: The licensing process, including work done by each agency to vet applicants; timelines to file review of license renewals; field compliance work; and complaints and citations against alcohol licensees.

Chapter II – Quota and Licensing System

Introduction

For more than 80 years, Montana has operated as a “control” state regarding the manufacture, distribution, and sale of alcohol. Virtually every bottle of liquor that is sold in the state, whether at a state liquor store or to a bar or tavern, first passes through the Department of Revenue (DOR) liquor warehouse in Helena. The sales of wine and beer are also tightly regulated, although these sales are permitted through private distribution networks.

Further, the state permits the retail sale of alcohol via a quota system, which bases the number of available alcohol licenses of various types on the populations of cities and counties in which the licensed businesses are located. Before discussing specific work related to the liquor licensing process, it is important to discuss the types of liquor licenses in Montana, license quotas, and the process for applying for available licenses. This chapter discusses these processes and concludes that initial applications for liquor licenses are processed within the required time frame.

Montana Offers Numerous Types of Alcohol Licenses

DOR offers several types of alcohol beverage licenses, each with its own privileges and requirements. These licenses fall within four main categories:

- ♦ **Retail Licenses:** Include several types of licenses that permit on-premises consumption, including all-beverage; city beer; city beer with wine amendment; and restaurant beer and wine (also known as cabaret) licenses. Also includes off-premises retail licenses.
- ♦ **Manufacturer/Importer Licenses:** Include domestic distillery, domestic brewery, domestic winery, out-of-state winery, foreign winery/wine importer, and foreign brewery/beer importer licenses.
- ♦ **Wholesaler/Distributor Licenses:** Include table wine distributor, beer wholesaler, and beer and wine distributor licenses.
- ♦ **Miscellaneous Licenses:** Include passenger carrier, sacramental wine, beer connoisseur, and public airport licenses, along with vendor permits and vendor representative registrations.

Within these categories, retail licenses make up the most licenses by volume, and the majority of our audit work was focused in this area. We conducted additional audit work in the area of manufacturer licenses, primarily via site visits and interviews with domestic brewery licensees.

The following table illustrates the various types of newly issued licenses from DOR.

Table 1
On-Premises Alcohol Licenses
(As of June 30, 2016)

Retail Outlets	All-Beverage	Beer	Wine	Beer/Wine	RBW*	Total
On Premises	795	55		381	165	1,396
On Premises w/Catering	612	2		58	79	751
Off Premises		81	7	807		895
Sacramental Wine			3			3
Veterans' Organizations	48					48
Fraternal	59					59
Airport	7			1		8
Resort	24					24
Floater	18					18
Enlisted Officers' Club	1					1
Public Golf Course				21		21
Nonprofit Arts				18		18
Carrier - Airline	4					4
Carrier - Railroad	1					1
Fairgrounds w/Catering				1		1
Total Retail	1,569	138	10	1,287	244	3,248
Manufacturers	Beer	Wine	Distilled Spirits	Total		
Domestic Brewery	71			71		
Domestic Brewery Storage Depot	5			5		
Domestic Winery		18		18		
Domestic Distiller License			20	20		
Foreign Brewery	94			94		
Foreign Winery		1,102		1,102		
Total Manufacturers	170	1,120	20	1,310		

Source: Liquor Control Division.

*Restaurant-Beer-Wine

Quotas in Place for Certain License Types

The number of certain types of retail alcohol licenses available within defined geographic areas is limited by a quota system in state law. Quotas apply to the most common types of on-premises consumption licenses, including all-beverage, beer, and restaurant-beer-wine licenses. The quota system was developed in the 1940s, and allows for a certain number of licenses in cities and counties based upon population.

For all-beverage retail licenses, for example, the quota is as follows:

- ♦ Incorporated towns of 500 people or fewer: two licenses.
- ♦ Incorporated towns or cities between 500 and 3,000 people: three licenses for the first 1,000 inhabitants and one license for each additional 1,000 inhabitants.
- ♦ Incorporated cities with populations greater than 3,000 people: five licenses for the first 3,000 people, and one license for each additional 1,500 people.

In each case, the quota boundary stretches to five miles beyond the border of the incorporated town or city. In cases where the boundaries of two municipalities are within 10 miles of each other, the two municipalities' populations are combined for quota purposes, and the prescribed number of licenses allowed can be put to use in either location.

Table 2 illustrates the quota limits for all-beverage licenses in select major cities and counties in Montana, as well as the number of those types of licenses available and issued in the state as a whole.

As evidenced by the table, several Montana cities currently have more licensed businesses than would be allowed under the statutory quota formulas. This is because at the time the quota system was put

into place, cities with more licenses than allowed under the new system were allowed to grandfather in all existing licensees. These licenses remain active and transferable in these locations. Similarly, a locality that loses population may legally maintain more licenses than would be permitted by its new, lower population.

Table 2
**Current Quotas and Actual All-Beverage License
Numbers in Largest Cities/Counties**
(As of March 2017)

Locality	Quota	All-Beverage Licenses Issued
Butte/Silver Bow	26	78
Great Falls	42	84
Cascade County*	28	15
Billings	76	109
Yellowstone County	52	15
Helena/E. Helena**	24	42
Lewis and Clark County	45	32
Bozeman/Belgrade**	37	51
Gallatin County	59	40
Kalispell	17	30
Whitefish/Columbia Falls**	11	24
Flathead County	82	64
Montana Total	1,238	1,460

Source: Compiled by Legislative Audit Division from Liquor Control Division data.

*In each case, county figures do not include numbers of licenses available within cities in those counties.

**For licensing purposes, boundaries extend five miles beyond municipal limits; so in cases where cities are within 10 miles of each other, the areas overlap and are combined.

Over time, this grandfathering mechanism combined with population shifts have led to some cities having far more active licenses than their populations might appear to allow by statute, while other cities have exactly the limit allowed by law although there is enough demand among the citizenry to support additional licenses. This is evidenced by the secondary market for existing licenses. Liquor Control does not track licenses available for resale across the state and instead directs people interested in existing licenses to consult with real estate agents or industry publications to learn of licenses for resale.

When an individual decides to give up an on-premises alcohol license, the license does not automatically revert to the state for redistribution. Rather, a licensee may sell a license to a buyer on the private market, at any negotiated price. The acquiring licensee still has to complete the application and background processes with Gambling Control and Liquor Control. The result of this system is a tremendous disparity in the value of existing licenses, depending upon where they are located. In some cities, an all-beverage license can fetch hundreds of thousands of dollars on the secondary market, while the same type of license in another city might be worth only several thousand to a prospective buyer.

Liquor Control maintains and regularly updates a spreadsheet showing the number of various types of licenses allowed by quota in the geographic locations around the state. The spreadsheet is updated to reflect changes in population as well as movement of licenses between jurisdictions. The spreadsheet is posted on the DOR Web page and is readily available to the public. In addition, there is very high interest in quota limits and the number of licenses available and issued from both the licensee community and many industry and advocacy groups. Thus, it is highly unlikely that a city or county would be issued more or fewer licenses than allowed by law.

All-Beverage Licenses Can “Float” From One City to Another

As cities grow in population, the number of licenses allowed under the quota system grows as well. However, there is another mechanism by which a city may accommodate more all-beverage businesses than allowed by population quota, as long as the license is “floated” into the city from elsewhere in the state and is not the creation of a brand new license. The net effect of floating is the movement of licenses to places where demand is greatest (based upon market forces), with no net change in the number of licenses statewide.

Section 16-4-204, MCA, states that a city can accept floated licenses until the number of all-beverage licenses reaches 133 percent of the population-based quota. The license

may only be floated in from a city that has more than 125 percent of the number of licenses allowed by current census-based quota. As with new all-beverage or beer licenses, when a city grows enough to become eligible for a floating license, the right to apply for that license is made available through a lottery. The lottery winner then has the right to purchase a license from elsewhere in the state where surplus licenses exist and float it into the new location. It is important to note that when a license is floated, any gambling rights associated with that license are stripped and can never be reacquired, so the locality into which the license is floated does not see an increase in gambling licenses, only in alcohol licenses.

New Licenses Available by Lottery

When a city's population grows to a size at which it is eligible for another license, DOR may host a lottery in which all people interested in owning a license in the city may submit an entry. Typically, DOR holds a lottery once a year, with several drawings for new licenses of various types in cities that have become eligible for additional retail alcohol licenses. If multiple people enter a drawing for a single license, a lottery is held. If only one person/entity enters a drawing for a single license, that person earns the right to apply for that license. If a license is advertised and nobody enters the drawing, that license stays with DOR and is available on a first-come, first-served basis to anyone who wants to apply for it.

As part of audit work, we observed a lottery for 18 licenses of various types in cities around the state. Among the drawings were: new beer licenses in Billings, Kalispell, Columbus, and Missoula; two all-beverage floating licenses into Bozeman/Belgrade; and restaurant-beer-wine licenses in Billings, Missoula, and Bozeman/Belgrade. The number of lottery entrants varied from just a few entrants for certain licenses to more than 100 entrants for others.

It is important to note that lottery winners have won the right to apply for a license; they have not won a license itself. Lottery winners still must meet all qualifications and criteria and pay all fees set out in the license application process. In order to discourage speculation, entrants in lotteries for floating all-beverage licenses, which by definition are bought on the secondary market and thus may cost thousands of dollars, must provide proof of financial wherewithal prior to the lottery, in order for the entry to be included in the drawing.

A total of eight people are involved in the lottery drawings, most from the Liquor Control Division but also an external witness from Department of Administration. The public is invited to attend, and several members of the public watched this drawing. For each drawing, each entrant is printed on an index card, and each index card is

sealed inside a plain white business envelope. The envelopes are prepared ahead of time and sealed (with evidence tape) inside a larger manila envelope. At the time of the drawing, the manila envelope is opened and the entries are dumped into a spinning drum. The drum is spun five times in each direction, then a Liquor Control employee reaches in for an envelope, which is handed to another employee and opened, with the name then read aloud. Several names are drawn for each license so that if the winner is not able or willing to complete the application process, the next name drawn is given the opportunity to apply for the license.

Figure 1
Lottery Drawing



After a Liquor Control Division employee opens a sealed envelope containing all entrants in a license drawing and deposits the entries in a drum, the drum is spun while several other Liquor Control employees and one from Department of Administration witness the process.

Source: Legislative Audit Division.

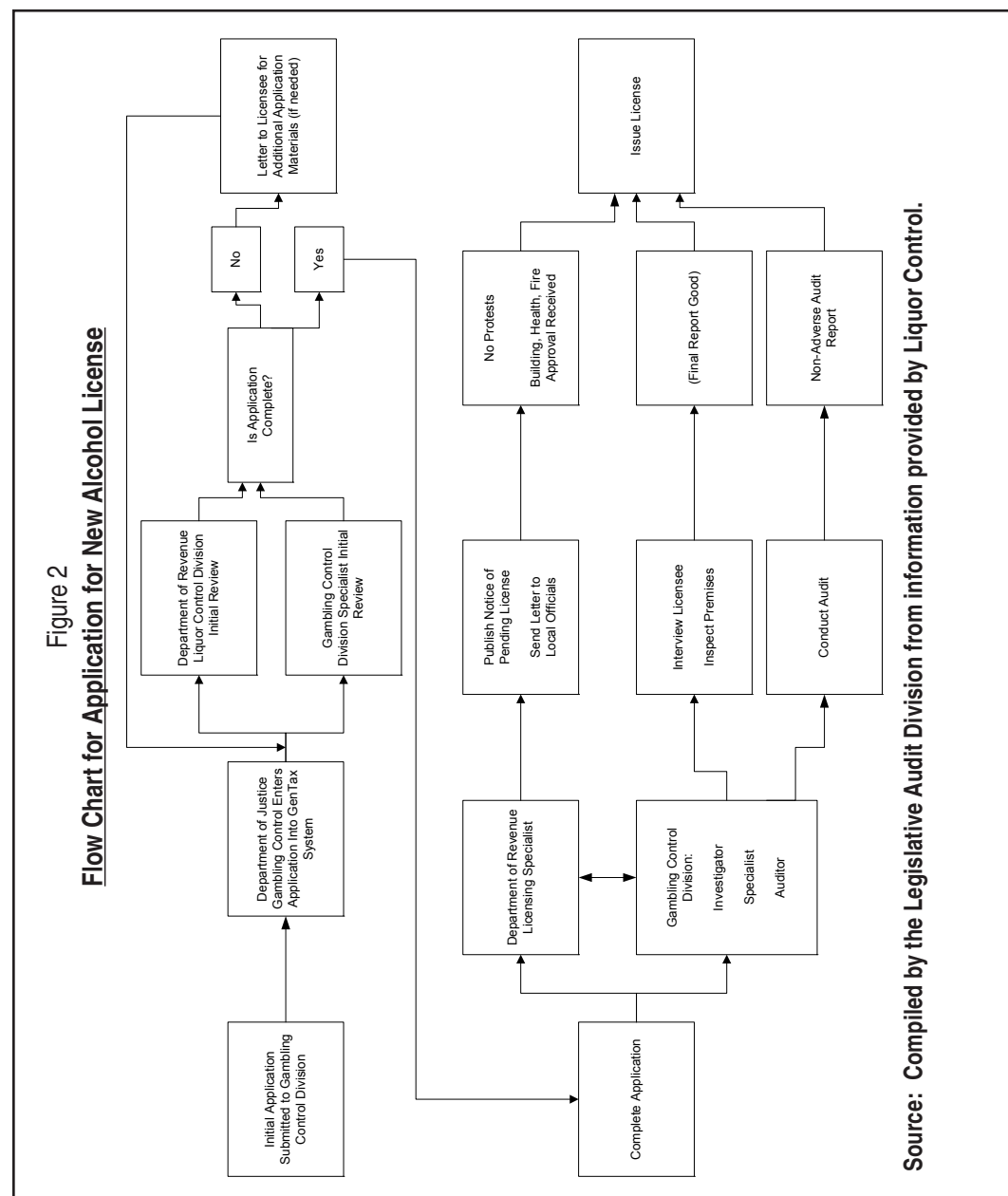
Through observation we determined that the lottery drawing for the right to apply for various retail alcohol licenses was conducted fairly, with appropriate controls among those charged with carrying out the draw, and in full view of the public.

Department of Revenue and Department of Justice Responsibilities in Liquor Licensing

Due to the unique nature of the approval of alcohol licensees, which is shared between two state agencies, a Joint Procedures document exists between DOR and DOJ that spells out how the roles and responsibilities of the two agencies are divided in the licensing process. The agencies are also guided by a shorter Memorandum of Understanding (MOU) that outlines services provided by DOJ to DOR in the licensing process. By law, the agencies have 90 days from the receipt of an application to complete the review process and, if approved, issue a license. Review of this process was part of our audit work and is discussed in Chapter III.

Most gambling licenses in Montana, including those permitting gaming machines and live card games, are by law available only to holders of certain alcohol licenses, including most all-beverage and beer licenses. Because of this, as well as the background investigations required of applicants for both types of licenses, applications for alcohol licenses go first to Gambling Control. Each agency, however, has several responsibilities in the processing of new license applications. The following paragraphs give some background on the delegation of responsibilities between the two divisions responsible for alcohol license application processing.

The following figure illustrates the concurrent work done by Liquor Control and Gambling Control in the processing and approval of initial license applications.



Department of Justice Gambling Control Division

In the initial licensing process for most types of alcohol licenses, Gambling Control receives the application and serves as the contact point between the applicant and the state. License applications are submitted to Gambling Control. Gambling Control is divided into East and West regions, and a total of 16 investigators work in field offices around the state. Gambling Control conducts background checks on all applicants and co-applicants. The division's auditors review the financial records provided in the application package. The division investigator also conducts an on-site observation of the proposed business location to ensure the description provided with the application materials is correct. Once the license applicant has met all of Gambling Control's requirements, the application is forwarded to DOR for final review and approval.

Department of Revenue Liquor Control Division

Concurrent with the licensing work done by Gambling Control, Liquor Control conducts its review of the license application to ensure it meets statutory requirements relative to ownership, payment of taxes and fees, business operation, and whether there is an available license of the desired type within statutory population quota guidelines. Liquor Control also advertises the application in local media and fields any questions related to the proposed location of the new licensed business. (Protests go through DOR's Office of Dispute Resolution.) Liquor Control ultimately approves the liquor license after all the necessary application materials are submitted, Gambling Control background investigations are completed, site inspection and other steps are taken by Liquor Control, and appropriate public notice is provided in local media.

Applications can be submitted electronically or via hard copy. Once received, the applications are entered by Gambling Control into GenTax, the software system designed for tracking all activity associated with the various types of liquor license accounts. Hard copy applications are scanned into the system. Once applications have been digitized, Gambling Control can share the application packages with Liquor Control, allowing staff at each division to work simultaneously to ensure all pre-approval requirements are complete.

In an effort to make a somewhat complex process as simple as possible for the applicants, all communication with applicants is handled by Gambling Control. Each agency, however, holds a series of responsibilities throughout the licensing process. If the applicant did not provide all required information, a "joint letter" is sent outlining any additional paperwork requirements that the applicant must meet. The intent of the joint letter is to ensure that applicants do not get phone calls, emails, or letters from staff at both departments requesting the same or similar information. Staff indicated

it is quite rare for a license application to be denied, in part because if a denial seems likely, the division will strongly encourage the applicant to withdraw the application.

All alcohol licenses must be renewed annually with DOR. License renewals are typically handled online and can be processed quickly if there have been no changes at the licensed business (change to floor plan, change to management or ownership structure, etc.). Renewals may also be submitted by mail. In either case, the renewal process is much more streamlined than the initial application process, particularly if there have been no significant changes to the business. As will be discussed later, Liquor Control does comparatively little compliance work with renewals compared to initial applications.

Licensing Process Is Consistent and Completed Within Required Time Frames

Our first audit objective was to determine whether the processes for reviewing and approving initial applications and renewals is consistent, and whether applications are approved within the time frame specified by state law. To address this objective, we selected and analyzed a random sample of 20 percent of the 388 license applications processed by Liquor Control and Gambling Control in calendar year 2015. This sample yielded 78 licenses. We reviewed these files in GenTax to determine whether the licensee files contained all required information and whether the applications were reviewed and approved within the statutory 90-day limit.

Applicants are required to provide a significant amount of information as part of the liquor licensing process. This information is used to verify ownership interests in the business, sources of financing and loans, and a business's management structure, among other criteria. Documentation requirements vary for applicants of different types of alcohol licenses, but examples of some of the more common documentation requirements include:

- ◆ An initial application form with proof of application payment
- ◆ Source of funding for the purchase, which may include possessory interest, loan documentation, promissory notes, security agreements, lease agreements, etc.
- ◆ Assumed business name filed with secretary of state
- ◆ Floor plans, certified surveys (for new locations)
- ◆ Balance sheet, income statement, other financial documents
- ◆ Management agreements, and verification of ownership interest (if any) in other alcohol beverage licenses
- ◆ Federal tax, identification, and licensing (for manufacturers)

- ♦ Menu, and actual or anticipated percentage of revenue from food sales (for Restaurant-Beer-Wine licenses)
- ♦ Department of Treasury Alcohol and Tobacco Tax and Trade Bureau (TTB) Brewers/Distillers Notice
- ♦ Label approvals (brewers and distillers)
- ♦ Notification to local newspapers of new alcohol license in process
- ♦ Local approvals for health, fire, safety
- ♦ Proof of background investigations of licensee(s), owners, managers (as required), etc.

An initial alcohol license must be processed and all background and other required steps be performed within 90 days of submission of the complete application. However, that timeline may be lengthened if the agencies determine that application materials are incomplete and additional information is required from applicants. In these instances, “tolling days,” or days during which the agencies are awaiting the provision of additional required information, do not count against the 90 days the agencies are allowed to process initial license applications. The 90-day clock does not start until an application is deemed complete and the review of materials can start. If an incomplete application is submitted, the agencies strive to review the materials and request additional information within seven days of receipt of the initial application. It is important to note that the licensing process is complex and touches a number of areas of the applicants’ lives and business interests, and a majority of applications are tolled at some point in the process while applicants are asked to provide additional information.

To help mitigate delays in the application process, Liquor Control can provide an applicant with “temporary operating authority,” which allows an applicant to open for business even if the application review process is not complete. This authority is available for 45 days, with one optional 45-day renewal, and can be offered only if the location in question was licensed for alcohol sales within the previous 12 months and the floor plan has not changed. Temporary operating authority is also available only if a complete application has been submitted and is in the approval process. Due to these restrictions, temporary operating authority is in practice available largely to new owners of previously existing licensed businesses, as opposed to owners of newly licensed businesses in new locations.

Our review of a sample of 78 license applications from calendar year 2015 indicated that all licenses were approved within 90 days (plus tolling days, in applicable instances), and the files contained all required information. Licenses often took longer than 90 days total to approve, but with tolling days these extensions are legitimate. Files

also included correspondence between the licensing divisions and the applicants, as well as proof of public notice and other documents. We also found both departments following consistent processes to review and approve liquor license applications.

CONCLUSION

Applications for various types of alcohol licenses are processed consistent with Administrative Rules and within the time frame specified by law. The two agencies responsible for processing initial alcohol licenses have worked to streamline the process and eliminate multiple points of contact for licensees.

Chapter III – Complaints and Compliance Efforts by State and Local Agencies

Introduction

This chapter addresses the manner in which complaints, including issues like suspected service to underage or intoxicated patrons, are fielded and acted upon by the two agencies charged with oversight of liquor licensing. It also discusses field compliance efforts, coordination with local law enforcement agencies in regard to liquor license violations, and other work by the agencies to ensure licensees are complying with all applicable statutes and rules.

In addition to processing initial applications, the Department of Justice's (DOJ) Gambling Control Division (Gambling Control) and the Department of Revenue's (DOR) Liquor Control Division (Liquor Control) each have responsibilities in the areas of receiving and responding to complaints about licensed businesses; doing work to ensure licensees are complying with all applicable laws and rules; and processing annual renewal applications for various types of alcohol licenses. The remainder of our audit work, conducted in these areas, will be discussed in this chapter. We reviewed the processes for initial license applications and renewals; investigated the processes for receiving and responding to complaints about licensed businesses; and reviewed administrative rules that field work indicated lacked clarity or have grown out-of-date.

Each Agency Fields Complaints About Licensees

There are times when someone may have concerns about how a licensed establishment is operated. For example, a patron may see an underage person being served alcohol or a bar, tavern, or brewery serving alcohol after legal operating hours. Someone who is concerned with how a licensed establishment is operating may file a complaint with Gambling Control, Liquor Control, or local law enforcement. Both DOJ and DOR have a role in fielding complaints related to liquor licenses. However, DOJ has the responsibility for conducting investigations or coordinating with local law enforcement who may be dealing with a complaint directly. DOR's role is generally limited to referring complaints to DOJ if the complaint meets certain requirements.

Per statute, complaints to Liquor Control must be in writing and verified, and then are passed along to Gambling Control for investigation. Liquor Control does not investigate complaints but rather refers them to other agencies, either DOJ or local law enforcement authorities. Complaints are then investigated by either Gambling Control or by local law enforcement agencies in the jurisdiction in question. Liquor Control staff noted while complainants are by law required to identify themselves, the agency

will make exceptions to the writing/verified complaint standard if, for example, an anonymous telephone caller indicates belief that his/her life may be endangered if the licensee were made aware of the source of the complaint.

Complaint Files Do Not Reflect Number of Alcohol Violations Cited

As part of our work, we reviewed Gambling Control's list of all complaints received in 2015. Of the 16 complaints, seven were related to alleged alcohol violations. Two of these were referred to local law enforcement; one was determined by Gambling Control to be unfounded and another showed no violation found. The remaining three were reported to DOR. Of the four complaints regarding "Over Service of Alcohol," two were investigated by Gambling Control, while the other two were referred to local law enforcement. The information provided by Gambling Control does not indicate what factors determine whether a complaint of this nature is investigated by the division or is referred to local authorities.

We also reviewed a log of citizen complaints received by Liquor Control in 2015. This log contained six complaints. File review indicated complaint files were not uniformly thorough or complete in the review or resolution of the issues presented. Proposed disciplinary actions were sent to the licensees in four of the six cases reviewed.

In addition, audit work determined that the two regulating agencies, Gambling Control and Liquor Control, have different statutory responsibilities related to the acceptance of anonymous complaints. Gambling Control accepts anonymous complaints and has a form on its website for citizens to file complaints regarding gambling, alcohol, or tobacco activity. On this form complainants can choose whether or not to identify themselves by name. Division officials indicated that the decision to accept anonymous complaints was driven by a desire to increase use of the agency's online complaint form, with a goal of learning of more violations across the state.

Table 3 illustrates the number of alcohol-related complaints received by Gambling Control and Liquor Control in 2015, as well as the number of "Notice of Violations" issued to licensees by Liquor Control the same year.

Table 3
Complaints Received and Violations Noticed
(2015)

Alcohol-related complaints received by the Gambling Control Division	7
Alcohol-related complaints received by the Liquor Control Division	6
"Notice of Violations" issued by the Liquor Control Division	151

Source: Compiled by Legislative Audit Division from Liquor Control Division and Gambling Control Division information.

As illustrated by the table, the two agencies received 13 alcohol-related complaints during 2015. Meanwhile, the DOR issued 172 citations in the same year. A number of the violations were for liquor licensing issues where licensees did not comply with specific licensing requirements. For example, lack of management agreements, undisclosed ownership interest, lack of timely renewal fee payment, or failure to provide documentation of server training were common violations licensees were cited for. Violations of this nature would largely be noted by Liquor Control staff in the licensing administration or renewal processes and would not necessarily be the result of complaints. The majority of the violations, however, were for issues such as over-service of an intoxicated person; service to an underage person; service after legal closing hours; and the like. These violations were initially cited by local law enforcement agencies and subsequently reported to Liquor Control.

The disparity between the number of complaints received by the two licensing agencies and the number of citations written by local law enforcement agencies indicated that complaints to DOR or DOJ are not a primary source of tips for potential violations of the laws and rules governing liquor licenses and licensees. Instead, these complaints are more typically made and acted upon at the local level generally because that is who local citizens will call when they have a concern with how a particular licensed establishment is operating and local law enforcement can respond to a complaint immediately. For example, a citizen witnessing an underage person or an obviously intoxicated person being served alcohol would typically call local law enforcement and not the state agency that oversees licensing. Local law enforcement also conducts its own random compliance checks.

File review indicated differences in the way each agency handles citizen complaints. This can in part be explained by DOR's lack of law enforcement authority, as well as the department cannot legally accept anonymous complaints. And as noted above, the majority of complaints about licensees are handled by local law enforcement agencies who are located in the immediate area and can issue citations to a licensee when necessary. These citations can then be communicated to Liquor Control and Gambling Control.

DOR does have some discretion in the assessment of penalties, based upon the licensee's past record, cooperation with Liquor Control staff, and other factors. Thus it would not be expected that every violation would be handled in an identical manner.

Additional, Thorough Compliance Reviews Should Be Conducted

Alcohol licensees are subject to regulations in numerous areas of their businesses. These regulations govern everything from the placement and wording of business signage, to having specific approved floor plans (including seating areas, walls, and service areas), legal hours of operation, criminal background checks of owners, and required training for all managers and direct servers of alcohol.

Ensuring compliance with the alcohol rules and regulations is not straightforward. DOR, which has authority to issue, deny, penalize, or revoke licenses, does not have an enforcement function. Instead, field compliance work is done primarily by local law enforcement agencies—police departments and sheriff’s offices. In addition to responding to complaints, local law enforcement may conduct more proactive compliance work in the form of “sting” operations in which an underage patron tries to buy alcohol from a licensed business. Gambling Control also performs field compliance work and has authority to cite businesses for violations, but currently this work is largely limited to measuring compliance with gambling laws and rules.

Gambling Control Investigators Could Test Liquor Compliance

Liquor Control does not perform random on-site inspections of licensees. According to division officials, field visits from Liquor Control compliance specialists to licensees are typically announced in advance and are scheduled specifically to address particular issues or questions that licensees may have. Liquor Control also tries to visit new licensees for what it calls “meet-and-greets,” giving the compliance specialists a chance to introduce themselves in person and make themselves available to licensees for any items that arise during the licensing process or the early days of the licensee’s operation. These visits are more informational in nature and not geared toward compliance work. If a Liquor Control staff member is scheduled to visit a licensed business, the staff member may try to schedule additional business visits in the same city or county. These visits are known ahead of time and their purpose is not intended as a check on compliance with applicable statute and rules.

In contrast, Gambling Control does conduct random on-site compliance checks across the state at businesses licensed for gaming, which by law means the businesses are also licensed for alcohol sales. Currently, Gambling Control investigators use a checklist for these compliance checks that includes only items related to compliance with laws and rules governing gaming. It does not include items related to laws and rules related to alcohol licenses. Gambling Control officials indicated that each visit may last around

30 minutes, depending upon whether any violations are found and whether the owner or manager of the business has any questions.

Gambling Control officials indicated a willingness to expand the scope of the random on-site compliance checks to include alcohol-related items on the agents' compliance checklists, and provided to us a draft of what an enhanced compliance checklist might look like. However, this draft checklist included just two items related to alcohol compliance: proper visible placement of the establishment's liquor license, and a question of whether the staff had been provided proper alcohol service training. Several other areas could also be included so Gambling Control field agents can conduct more thorough compliance reviews to ensure licensees meet all the conditions of their alcohol license. Examples of other areas investigators could assess include the continued suitability of the premises for an alcohol service business, and whether the space is laid out in accordance with rules. Requirements such as the business's layout matching the floor plan provided to DOR, proper display of alcohol license, alcohol inaccessibility to patrons, and proof of server training could all be confirmed by Gambling Control investigators during a routine site visit. Gambling Control could also expand the scope of its on-site compliance inspections by visiting businesses that are licensed for retail alcohol sales, even if these businesses do not offer gaming. A more recent draft checklist, provided later in the audit process, included several more alcohol-related items.

Currently, there is limited field compliance work occurring from the state agencies responsible for liquor licensing. On-site compliance work is important as a tool to ensure that licensed businesses are run in accordance with state law and administrative rules. Expanding the role of Gambling Control in both the types of licensees visited and the laws and rules checked for compliance would help the agencies ensure proper operation of alcohol-licensed businesses. State law authorizes DOJ to investigate alcohol violations and to act as a liaison to local law enforcement. The memorandum of understanding between Liquor Control and Gambling Control does not currently address nor require Gambling Control to conduct liquor-related compliance reviews from either agency. It should be updated to define Gambling Control's responsibilities for conducting these reviews.

RECOMMENDATION #1

We recommend the Department of Revenue and Department of Justice work together to add observable alcohol compliance items to the Gambling Control Division's on-premises inspection checklist, and conduct inspections at licensed businesses that are not also licensed for gambling.

Liquor Control Could Improve Efforts to Confirm Licensee Attestations on Application Renewal Forms

All alcohol licensees must renew their licenses annually. This renewal can be submitted in one of two ways—electronically, via the DOR website, or on a paper form. The form provided for renewal varies slightly by the type of license held, but in each case the licensee is expected to provide updated information to Liquor Control regarding the activities of the licensed business in the last year.

This annual renewal process provides DOR with an opportunity to review licensee activities and ensure that any violations, changes to ownership structure, or other changes to the licensing arrangement are approved and documented with the department. This is essential for ensuring that DOR maintains current and accurate information related to all of the statutory requirements for alcohol licensing. For example, licensees are asked if there is a change in the ownership structure of the licensed business, whether the licensee or employees have been issued any alcohol-related citations, and whether all employees have received appropriate training.

Improving Communication With Local Law Enforcement

Most proactive on-site compliance work for liquor-related laws is done by local law enforcement agencies (sheriff's offices and police departments) in jurisdictions across the state. Frequently this occurs in the form of "sting" operations that involve sending underage individuals into licensed establishments to attempt to purchase alcohol. Local law enforcement also responds to reports and, if necessary, writes citations to licensees or their employees for other liquor law violations that come to their attention. Examples include over-serving of an intoxicated person, selling outside of legal hours, or selling unlawful alcoholic beverages.

Local law enforcement agencies are encouraged and reminded to report to Liquor Control any citations that are written to licensees or their employees. As part of our audit work, we learned that city and county law enforcement agencies are in fact not obligated by law or rule to report alcohol violations to Liquor Control. Consequently, there is no assurance that Liquor Control will become aware of every violation that is cited across the state. Liquor Control officials indicated they are aware of liquor license citations that have been issued by local law enforcement and not reported to the division. Thus, it is impossible to readily know how many alcohol-related citations are issued to licensees in a given period of time.

Liquor Control provides a document to local law enforcement officials they can use to submit notice of violations, but submission of the form is not mandatory.

Consequently, Liquor Control officials stated that alcohol citations are not always reported to the division. Ultimately, however, it is Liquor Control's responsibility to determine if liquor licensees have received citations. When liquor violations do not get reported to the division, it is most likely due to oversight on the part of the local law enforcement agency. However, Liquor Control staff indicated there have been instances, particularly in smaller communities, where local law enforcement did not want to foster ill relations with local citizens by reporting alcohol violations to the division. When liquor violations do not get reported to Liquor Control, they do not have information necessary to conduct proper oversight of liquor licensing activities, particularly when it comes to making annual license renewal decisions.

Verification of Citations

All holders of alcohol licenses, regardless of type, must renew their licenses through Liquor Control once a year. The renewal process is much simpler than the process for an initial application, particularly if there are no changes to the licensed business's ownership structure or other major changes. Applicants can submit their renewal forms online or on paper. Among the questions licensees are asked on the renewal is whether they or anyone employed by the licensed business has been issued an alcohol citation within the past 12 months.

However, while licensees who file to renew their licenses are asked whether they or their employees have received any alcohol-related citations within the last year, DOR does not necessarily know of nor proactively confirm any information provided by the applicants. Liquor Control staff do check division documentation for the renewing licensee to see if any violations have been reported. However, Liquor Control staff do not conduct further work to confirm there have been no citations against licensees or their employees in the past 12 months. By not verifying these claims, the division may not learn of actions by the licensee that could result in a penalty or loss of license.

By developing a system for selecting even a sample of license renewals and contacting local law enforcement agencies during the license renewal process, Liquor Control would be better able to ensure all violations are accounted for and licensees are cited or otherwise punished for violations where appropriate. Liquor Control encourages local law enforcement agencies to report all citations and has developed and made available a form for doing so, but to date the onus remains on the local agency to report violations. Liquor Control does not have a process to contact local law enforcement agencies to determine if licensees have received citations that could impact whether the license can be renewed.

RECOMMENDATION #2

We recommend the Department of Revenue implement a process to determine if licensees renewing liquor licenses have been cited by local law enforcement agencies during the most recent licensing period when conducting the annual license renewal process.

Restaurant-Beer-Wine License Renewal Process Does Not Include Review Source of Gross Revenues

Montana Code and Administrative Rules provide a number of requirements and conditions for holders of various types of on-premises alcoholic beverage licenses, including certain attestations for all licensees and other requirements that are unique to all-beverage, beer, or restaurant-beer-wine licenses. The law includes requirements that people serving alcohol undergo safe server training within a time of beginning their employment. The law also spells out consequences for violations of liquor laws by licensees. For restaurant-beer-wine (RBW) licensees, a specified percentage of a licensee's revenue must come from the sale of food versus alcohol. We identified weaknesses in Liquor Control's process to verify if RBW license holders meet this requirement during the annual renewal process. Section 16-4-420(1)(a)(i), MCA, specifies that restaurant-beer-wine licensees must generate 65 percent of the business's yearly gross revenue from the sale of food. On the annual renewal form, licensees are asked to attest that the gross income of the business for the previous year did meet this threshold.

Through audit work we determined Liquor Control does little follow-up work in the area of verification of information provided by licensees. Previously, RBW licensees were required to provide income statements verifying the proper ratio of food sales to alcohol sales was met. Recently, however, Liquor Control stopped requiring this income statement, and now simply asks the licensee to affirm that the business is selling the appropriate amount of food. Officials indicated because they do not require supporting documentation or other proof of attestations on the renewal form, they do not feel it is appropriate to ask for proof of food sales either. They indicated certain forms of proof of compliance are challenging for licensees to provide, and even this proof (income statement for RBW licensees, for example) is difficult to verify. They added that Gambling Control auditors may request proof of food sales from renewal applicants, to ensure that licensees understand and are meeting the requirement.

We recognized through interviews and other audit work that Liquor Control is intent on meeting deadlines and providing good customer services to licensees. However, in its efforts to meet deadlines the division is taking limited action to verify licensees renewing their RBW licenses meet the statutory requirements of the license. We reviewed a sample of 45 license renewals of all types. However, we found this issue to be specific to the 10 RBW license renewals we reviewed, as these are the only type of license that has a food sales requirement.

Better Compliance Work Would Help Verify Licensee Claims

By not being more proactive in seeking proof of compliance from licensees, Liquor Control is unable to verify that licensees are complying with all appropriate statutes and rules. An RBW licensee could be earning half or more of its gross revenue from the sale of alcohol, yet report to DOR that its food revenue is 65 percent of the business as required by law. Liquor Control currently trusts the licensee's response on the annual renewal form that 65 percent of the business's revenue came from food sales and not from the sale of alcohol.

Liquor Control Has Responsibility to Ensure Licensing Requirements Are Met

The division has a responsibility to ensure RBW licensees not only meet gross revenue requirements of their licenses, but also that all licensees abide by the same requirement. By not obtaining information from RBW licensees showing where gross revenues come from, the division increases the risk that licensees will be held to a different standard on meeting license requirements. Specifically, our review of a sample of license renewal files found no instances of RBW licensees reporting gross revenue that did not meet the necessary requirements. However, without a process to verify if these requirements are being met, it could create unfairness in the renewal process between those licensees working to meet this requirement and those that are not because they know their response will not be verified. Additional work to verify claims of appropriate food and beverage sales, to the extent possible, would help ensure the spirit of the restaurant-beer-wine provision is met. This would not necessarily require Liquor Control review every RBW license being renewed. For example, the division could implement a process to review a sample of licenses being renewed each year. However, if verification of this information proves challenging or impossible to achieve, a change in the law eliminating the requirement that 65 percent of gross revenue for RBW license holders come from food may be in order.

RECOMMENDATION #3

We recommend the Department of Revenue:

- A. *Require additional information from restaurant-beer-wine licensees to confirm 65 percent of gross revenue comes from sale of food, or*
 - B. *Seek legislation to change Montana Code related to business food sales criteria for restaurant-beer-wine licensees.*
-

Some Licensees Given Conflicting Information

Interviews with licensees determined the system and timelines for applying for and renewing licenses is generally working as intended, and that applicants are largely treated in a consistent manner by officials from the two state agencies. However, we did learn of incidents in which licensees were given conflicting direction from multiple licensing officials, which upon further audit work in each case indicated to us that administrative rules are outdated and in need of updating. Specifically, much of the confusion relates to prospective beer manufacturing businesses with an attached taproom receiving conflicting information about what constitutes appropriate separation between the manufacturing and service sides of the business. Such confusion can result in delays in businesses opening and lead to lost revenue if a business receives conflicting guidance from different state agencies.

Administrative Rules of Montana (ARM) offer vague and conflicting guidance related to the separation of alcohol manufacturing businesses from other businesses (alcohol licensed or other) operating under the same roof. Rules indicate a license for on-premises alcohol consumption “must be operated at premises that are physically separated by permanent walls from any business not directly related to the on-premises consumption of alcoholic beverages.” This has become an issue in the case of brewery manufacturing businesses and adjacent sampling taprooms. These types of businesses were not recognized by law at the time the rule was written. Field work included visits to licensed businesses where questions from owners regarding walls and signage were prevalent.

When Is a Wall a Wall?

The rule is unclear whether, for example, the manufacture of beer is “directly related” to the on-premises consumption of that beer, and whether or not “floor-to-ceiling” walls are required. Further, “floor-to-ceiling walls” are not defined, leaving Liquor Control staff to consult a dictionary to determine the type of wall that is acceptable. Questions

have arisen as to whether non-solid walls with wrought iron supports are sufficient, as well as whether a wall that reaches the height of a standard ceiling is acceptable in a space with a two-story ceiling. Ambiguity has created confusion among certain licensees, as well as among Liquor Control staff, regarding what constitutes a wall and what is needed to satisfy the separation requirements between alcohol manufacturing and other businesses. There is also some question as to whether a beer manufacturing business is “directly related” to the consumption of alcoholic beverages in an adjacent and associated taproom. In one instance, a license approval was delayed for several months after a business was initially told its floor plan met legal requirements, then later was denied after the separation wall issue came to light.

Field observations indicated that licensees are not all held to the same standard with regard to this administrative rule. For example, while the rule calls for a floor-to-ceiling wall separating alcohol manufacturing from other businesses, we observed one brewery/taproom at which the wall was substantially high enough to prevent customers from accessing the manufacturing business, but did not reach the ceiling of the building, which was at least two stories high. While the wall was clearly high enough to meet the intent of the rule by preventing access to the manufacturing area, it does not meet the letter of the rule.

Brewery Signage Requirements Not Clear

Another issue that arose during audit work was the question of signage and what types of exterior signs are allowed for various types of manufacturing and retail alcohol businesses. Specifically, questions were raised about signs indicating a business is a “brewery” or “brewing company;” whether manufacturing activity should be required at a location that has such a sign, even if the words “brewery” or “brewing company” are simply part of the company’s name; and how specific signage needs to be displayed over specific entrances when manufacturing and licensed taprooms are operating under the same roof. Again, this does not reflect the current landscape of manufacturing and licensed retail sales available in Montana today. Consequently, neither licensees nor the department are clear on what requirements apply to breweries, which were not licensed at the time the rule was written.

Administrative Rules Are Being Updated

Administrative Rules should be current with regards to the types of manufacturing and alcohol service businesses legally allowed in the state, and consistent in their treatment of those businesses and how they are separated from distinct or related businesses operating within the same building. Through audit work we learned of inconsistencies in the treatment of the wall issue for businesses that share the same building as well as exterior signs that should be allowed outside of businesses advertising themselves as

alcohol manufacturers, such as breweries. Not having administrative rules that reflect current alcohol manufacturing activities may lend uncertainty to the business plans of would-be licensees.

Administrative Rules of Montana have not kept pace with the changing nature of alcoholic beverage licensing and the variety of types of licensed businesses allowed. The section of Administrative Rules that calls for walls of separation between these types of businesses was established prior to the legalization of tasting rooms or other licensed beverage businesses set up adjacent to and/or sharing space with beer breweries. Since the law was put into place, the landscape for beer manufacture and licensed businesses has changed dramatically, to include new types of on-premises alcohol licenses that were not in use when the rules were put into place.

Further, it is becoming more common for breweries and/or taprooms to apply for full beer licenses, to extend their operating hours and not have a hard limit on alcohol sales. However, this change in license can change how these businesses are categorized by rule, and there has been no clear guidance in ARM regarding signage for these new types of co-licensing relationships.

By working with members of the regulated community (brewers and others) to refine administrative rules, DOR can help ensure its rules reflect the current landscape for licensed businesses in Montana. While rules are not necessarily written to accommodate the wishes of businesses, the agency should be proactively involved in understanding the context for the state's regulatory activity, taking into consideration all of the various types of licensed businesses allowed by law.

Over the course of the audit, DOR drafted and vetted new rules to address these and other issues. These rules took effect on April 29, 2017.

RECOMMENDATION #4

We recommend the Department of Revenue implement recently adopted Administrative Rules regarding:

- A. *Physical separation requirements between alcohol manufacturing operations and other attached businesses.*
 - B. *Exterior signage requirements on beer manufacturing businesses, taprooms, and other types of co-located alcohol licensed businesses.*
-

DEPARTMENT OF REVENUE
DEPARTMENT OF JUSTICE

DEPARTMENT RESPONSES



Mike Kadas
Director

Montana Department of Revenue

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JUN 07 2017

LEGISLATIVE AUDIT DIV.



Steve Bullock
Governor

June 6, 2017

Angus Maciver, Legislative Auditor
Legislative Audit Division
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State Capitol Building
P.O. Box 201705
Helena, MT 59620-1705

Re: Coordination of Liquor Licensing Compliance Programs Performance Audit (16P-02)

Dear Mr. Maciver:

Thank you for the opportunity to respond to the performance audit of the coordination of liquor licensing compliance programs, managed by the Liquor Control Division of the Department of Revenue and the Gambling Control Division of the Department of Justice.

Recommendation #1

We recommend the Department of Revenue and Department of Justice work together to add observable alcohol compliance items to the Gambling Control Division's on-premises inspection checklist, and conduct inspections at licensed businesses that are not also licensed for gambling.

Concur. The agencies recognized the need for improvement and have jointly drafted new premises inspection forms to assess suitability and operations for the Gambling Control Division investigators to use in the field for inspecting proposed/licensed premises. There are now inspection forms for each license type, and include more detailed information. For instance, the manufacturing license inspection form now has 29 items to verify (depending on license type requested/issued) and the on-premises retail inspection form now has 18 points of review. The planned implementation date for using these new forms is July 2017.

Recommendation #2

We recommend the Department of Revenue implement a process to determine if licensees renewing liquor licenses have been cited by local law enforcement agencies during the most recent licensing period when conducting the annual license renewal process.

Concur. The Department will review and implement a system for all license types by conducting random sampling of the annual renewals to assess potential violations of alcoholic beverage regulations in the preceding year. Where the Department has authority, the Department will

contact local law enforcement agencies to assess if violation(s) of the alcohol beverage regulations occurred.

Recommendation #3

We recommend the Department of Revenue:

- A. Require additional information from restaurant-beer-wine licensees to confirm 65 percent of gross revenue comes from sale of food, or*
- B. Seek legislation to change Montana Code related to business food sales criteria for restaurant-beer-wine licensees.*

Concur. The Department will evaluate what additional information can be requested to ensure the food sales requirement is met. This process will be in addition to the existing process of assessing sales reported on the financial statements of newly issued restaurant beer wine licensees on a sample basis.

The Department will also review and assess current liquor statutes and seek legislation as determined necessary to address the criteria for food sales.

Recommendation #4

We recommend the Department of Revenue implement recently adopted Administrative Rules regarding:

- A. Physical separation requirements between alcohol manufacturing operations and other attached businesses.*
- B. Exterior signage requirements on beer manufacturing businesses, taprooms, and other types of co-located alcohol licenses businesses.*

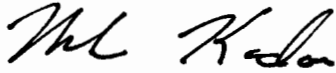
Concur. New updated rules have recently been adopted to clarify the physical separation requirements between a manufacturer and other attached businesses, and to clarify the requirement for exterior signage for co-located alcoholic beverage licensees. The new rules are now effective and will be applied when a “*party applies to obtain a license, transfer ownership interest in an existing license requiring the vetting of a new party pursuant to 16-4-401, MCA, change the location where a license will be operated, or make alterations to a premises with a floor plan that the department approved.*”

The updated rules can be found on the State of Montana Secretary of State website.

On behalf of the Department of Revenue, thank you for allowing us the opportunity to respond to the performance audit report and the opportunity to meet and discuss the process, views, and recommendations with Legislative Fiscal Division and Department of Justice staff. I would also

like to express my gratitude for the objectivity and professionalism in approach and journey of this audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Mike Kadas". The signature is fluid and cursive, with the first name "Mike" and last name "Kadas" clearly distinguishable.

Mike Kadas, Director
Department of Revenue

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STATE OF MONTANA

Tim Fox
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June 2, 2017

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JUN 05 2017

LEGISLATIVE AUDIT DIV.

Mr. Angus Maciver
Legislative Auditor
Room 160
State Capitol Building
P.O. Box 201705
Helena, MT 59620-1705

Re: Coordination of Liquor Licensing Compliance Programs (16P-02) (response to your letter dated May 30, 2017)

Dear Mr. Maciver:

Thank you for your May 30, 2017 letter and for the opportunity to respond to the Legislative Audit Division's May 2017, Department of Revenue and Department of Justice Performance Audit titled, Coordination of Liquor Licensing Compliance Programs (16P-02).

Our response to the recommendation is below.

Recommendation # 1. We recommend the Department of Revenue and Department of Justice work together to add observable alcohol compliance items to the Gambling Control Division's on-premises inspection checklist, and conduct inspections at licensed businesses that are not also licensed for gambling.

Concur. The Department of Justice has been actively working with the Department of Revenue over the last year to develop inspection checklists for each of the categories of alcoholic beverage license types. As indicated in the report, a draft checklist was supplied during the latter part of the audit. The draft checklist provided includes all the suggested items in the report and will be finalized and put into use starting July 1, 2017.

The department is also working on a plan to begin conducting random inspections at businesses with an alcoholic beverage license that are not also licensed for

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MONTANA DEPARTMENT OF JUSTICE

Legal Services Division ★ Division of Criminal Investigation ★ Highway Patrol Division ★ Forensic Science Division
Gambling Control Division ★ Motor Vehicle Division ★ Information Technology Services Division ★ Central Services Division

gambling. This change will begin with the implementation of the new forms on July 1, 2017.

If you have any questions, please feel free to contact Angela Nunn, Gambling Control Division Administrator at 444-5693.

Sincerely,

A handwritten signature in black ink, appearing to read 'T. Fox', with a stylized flourish extending from the end.

TIM FOX
Attorney General